Outcomes and Risk-Based Supervision in Pensions: The Case of Costa Rica

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The Costa Rican Pension System

Multi-pillar Pension System:
- First pillar is Social Security and other Defined Benefit systems.
- Second pillar is Mandatory Defined Contribution.
- Third pillar is Voluntary DC.
- Fourth pillar is Non-contributory (means-tested)

Majority of population was contributing, until recently, 8.5% for Social Security pension and 4.25% for Mandatory DC. Total of 12.75%

Recent increase of another 0.66% for Social Security is in discussion.
Challenges for SUPEN

People don’t want the specifics, they want pensions!

• Supervise DB funds with sustainability problems: their parametric design has not adjusted to fast demographic changes.

• Supervise a quickly-growing DC system that is large for the Costa Rican financial markets.
The external context

- Decrease in fertility rate.
- Increase in longevity.
- Small domestic financial markets.
- Lack of expertise and resistance to invest funds outside the country.
- Slow growth and low interest rates worldwide and in Costa Rica for the past few years (and foreseeable future?).
- Fiscal stresses within Costa Rica.
The internal context

- Compliance-based supervision: a questionnaire for the Pension Operators has over 400 items.
- Perception of micro-management, e.g. detailed rules for investment, excessive data requests.
- Internal islands: little communication between divisions.
- SUPEN is a decentralized entity linked to the Central Bank of Costa Rica which complicates political communication due to perceived tension between financial sector objectives and social security objectives.
Desired Longer-run Outcomes

In FIRST project: “to promote a pension system that is trusted, sustainable and efficient that delivers adequate pensions to all eligible workers”

• Strengthened risk management at pension funds.
• More opportunities for pension funds to diversify investments.

Some additional issues:
• Role of pension promoters as true advisers.
• Empowerment of affiliates: easy to understand information.
• Pension funds could offer a diversity of non-financial products.
• Own the robots?
FIRST Project priorities

• Increase actuarial credibility of SUPEN to address funding concerns of DB pension plans.
• Pension funds have to understand what is expected of them through inspection and guidance.
• Pension fund governance is key.
• RBS also requires clear processes to define those risks that will be a priority. For this, map inherent and residual risks.
• Linkage between training, budgetary cycles and the supervisory cycle.
Outcomes Based Diagnosis and Assessment (OBDA)

- Environment and Design
  - Economic and political environment
  - Framework – other pillars and key rules
  - Market Structure, Entities & Governance
- Supervision

Outcomes
- Efficiency
- Sustainability
- Coverage
- Adequacy
- Security

OBDA develops case for new regulations as well as broader dialogue with government on risks outside scope of regulator/supervisor that could improve pension outcomes e.g. review of social security, data and ID module, financial inclusion strategy or capital market ‘deep dive’.

Outcomes and Risk Based Supervision (ORBS)

- Long run outcome-focussed objective
- Map inherent and residual risks to objective
- Develop risk mitigation strategies prioritized relative to costs and benefits
- New principles and best practice guides published as part of risk mitigation strategy
- New regulations - including to market structure if most effective solution to risk
- New risk-based off-site and on-site supervision plus training & communication
- Annual strategy and M&E cycle to review and revise approach based on evidence
Current situation

- The islands have been rejoined: more internal communication and multi-level supervision to homogenize analysis.
- New actuarial regulation and internal models.
- Even using older regulations, the 2015 Supervision process had a much stronger focus on governance and risk management.
- New Risk Regulation has passed first stage of approval, it was developed with the input and feedback of the 2015 process.
- Organizational changes such as developing specialized units in risk and investments have been delayed due to austerity.
The big picture

- The whole point of risk-based supervision is that the pension industry is fundamentally risky: get money now, deliver safely decades later.
- Too hard to figure out all the risks in advance and codify in legislation to force compliance.
- Spectrum from compliance to responsibility of managers and RBS.
- From 2003 to 2013 some risk ideas but still too close to pure compliance.
- 2013 reforms plus WB ORBS got SUPEN closer to RBS in daily practice of supervision, but regulations still had many compliance elements.
- WB ORBS and other feedback crucial to design the new Risk Regulations that, when approved, should move us even closer to a pure RBS.
THANKS

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